The new standard addresses classification and measurement of financial assets and liabilities, provides a new set of hedge accounting rules and prescribes new principles on the impairment of financial assets.

AASB 9 Financial Instruments is effective from 1 January 2018

The standard applies for reporting periods beginning on or after 1 January 2018. The date of initial application of AASB 9 Financial Instruments for a 30 June entity is 1 July 2018, and for a 30 September entity is 1 October 2018. For these entities the beginning of the comparative period is 1 July 2017 and 1 October 2017 respectively.

Transition principles for classification and measurement (including impairment)

The three main transition principles for classification and measurement, including impairment, are:

- The standard is to be retrospectively applied but there are a number of exceptions;
- The standard does not apply to items that are derecognised at the date of initial application (DIA) of the standard; and
- There is a choice whether to restate comparatives or not. Comparatives should only be restated without the use of hindsight. This choice is to be applied consistently across all aspects of AASB 9.
Transition requirements are complex and require various assessments to be made at different points in time.

There is one assessment to be made at the date of initial recognition of the instrument, and three assessments to be made at the date of initial application of the standard.

**The two key dates where assessments are required to be made are the date of initial recognition of the instrument and the date of initial application of the standard.**

<table>
<thead>
<tr>
<th>Prior periods</th>
<th>Comparative period</th>
<th>First year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 2017</td>
<td>1 July 2018</td>
<td>30 June 2019</td>
</tr>
</tbody>
</table>

**Date of initial recognition**

The one assessment to be made at the date of initial recognition is whether financial assets have cash flows that are solely payments of principal and interest (the SPPI criterion). Entities are required to undertake this assessment based on the facts and circumstances existing at that date.

**Date of initial application**

The three assessments that are to be made at the date of initial application are:

- Identify the business model for financial assets
- For equity investments, consider whether they are held for trading and if they are not, whether the entity would elect to designate them as fair value through other comprehensive income (FVOCI); and
- Consider whether any qualifying financial assets and liabilities should be designated at fair value through profit and loss (FVTPL).

**Business model**

The new standard requires the business model assessment for financial assets that meet the SPPI criterion to be undertaken as at the date of initial application of the standard. Organisations are not required to consider business models that may have applied in previous periods. The resulting classification is applied retrospectively, irrespective of the organisation’s business model in prior reporting periods.

As a reminder, organisations will need to consider the impact on their business model if it enters into off balance sheet debt factoring facilities or if its funding strategy is to sell assets into a funding or securitisation vehicle when it has built up a sufficient volume of loan receivables.

**Designation for equity investments**

For organisations that have investments in equity instruments, the entity can elect to designate those instruments at FVOCI where they are not held for trading purposes.

In relation to unquoted equity investments that were measured at cost under AASB 139 Financial Instruments: Recognition and Measurement, AASB 9 requires such investments to be measured at fair value from the date of initial application. Equity investments are no longer permitted to be measured at cost. This requirement can only be applied prospectively and organisations cannot restate the comparatives for this change.
FVTPL designations
Organisations may designate financial assets and liabilities at FVTPL at the date of initial application based on the facts and circumstances at that date. This may result in revoking any prior designations, and new designations. The resulting classification is to be applied retrospectively, irrespective of prior period designations.

Application of the transition rules
The following examples illustrate how an organisation would retrospectively apply the standard given that it is only applicable to instruments that exist at the date of initial application and that it is at this date that the various elections and designations are required to be made.

In essence, this will result in a mixture of AASB 139 and AASB 9 accounting for the comparative year for those entities electing to restate the comparatives.

All examples assume a 30 June year end entity.

Example 1 – Items already derecognised at date of initial application
This example reflects an entity that has two equity investments, Equity A and Equity B. Both of the investments are classified as available-for-sale under AASB 139. The entity has elected to measure the equity investments in this portfolio as FVOCI upon adoption of AASB 9.

Equity A was purchased for $100. An impairment loss of $30 had been recognised for Equity A prior to the beginning of the comparative year as fair value (FV) has decreased to $70. Equity A’s FV decreased further during the comparative year, and a further loss of $10 was recognised during the comparative year. Equity A still exists at the date of initial application (DIA).

Equity B was bought for $80 and it was sold during the comparative year for $120. A gain of $40 was recognised during the comparative year.

If the entity elects to restate its comparatives:
- there would be no adjustment made for Equity B because it does not exist at the DIA
- for Equity A, assuming the entity has a separate FVOCI reserve, it would transfer a negative $30 from the opening retained earnings to this reserve at the beginning of the comparative year, that is, at 1 July 2017. In addition, it would reverse the impairment loss of $10 from the income statement and recognise this loss against the FVOCI reserve for the year ending 30 June 2018.

This example highlights there is a mixture of AASB 139 and AASB 9 accounting in the comparative year. The gain on disposal of Equity B during the comparative period will remain in the income statement, consistent with the requirements of AASB 139. No adjustment is to
be made as this asset does not exist at the DIA. (When the entity sells Equity A in the future, no gain or loss will be recognised in the income statement. Any movement will be recognised in the FVOCI reserve.)

If the entity elects not to restate, it would at the DIA, that is, 1 July 2018:

- transfer an accumulated loss of $40 for Equity A from the opening retained earnings to the FVOCI reserve.

**Example 2 – Reclassification of assets**

The following example looks at an organisation that will be reclassifying an asset that meets SPPI criteria from available-for-sale to amortised cost.

This example assumes the loan is interest only with a face value and fair value of $100 at inception. The fair value was $103 at the beginning of the comparative year and $102 at DIA.

If the entity elects to restate comparatives, it would:

- adjust the carrying amount of the asset from 103 to 100 against equity at the beginning of the comparative year, that is, 1 July 2017;
- recognise a provision for impairment for this asset against the opening retained earnings as at 1 July 2017; and
- recognise interest income of $8, and any movement in the provision for impairment in the income statement for the year ending 30 June 2018.

If this entity elects not to restate, it would at the DIA, that is, 1 July 2018:

- restate the carrying amount of the asset from 102 to 100 at this date against equity; and
- recognise a provision for impairment for this asset against the opening retained earnings.

**Example 3 – Retrospective application**

This scenario looks at an entity that has three pools of SPPI assets measured at amortised cost:

- Pool A existed at the beginning of the comparative period and at the DIA;
- Pool B existed at the beginning of the comparative period but were all settled during the comparative year; and
- Pool C was originated during the comparative year.
If this entity elects to restate comparatives:

- it would restate opening retained earnings at the beginning of the comparative year, 1 July 2017, for adjustments arising from applying the expected credit loss model to Pool A only; and
- there would be no restatement for Pool B as it does not exist at the DIA.

The impairment provision amount is required to be estimated for Pool A retrospectively using the expected credit loss model. This adjustment is determined based on whether or not there has been a change in credit risk from inception to this date. This assessment is made based on the facts and circumstances that existed at 1 July 2017.

If the entity elects not to restate, it would at the DIA, that is, at 1 July 2018:

- adjust opening retained earnings for changes in the impairment provision amount for both Pool A and Pool C based on changes in the credit risk from inception of those assets to this date.

**Hedge accounting: Transition principles**

The transition principles for hedge accounting are to be applied prospectively with one exception as explained below.

Applying the hedge accounting requirements **prospectively** means that entities cannot backdate hedge relationships that are only allowable for hedge accounting under AASB 9. For example, AASB 9 allows entities to apply hedge accounting to a hedge of an aggregated exposure. Aggregated exposures were not eligible hedged items under AASB 139. Accordingly entities are not able to apply this new requirement retrospectively, even if the AASB 9 hedge criteria would have been met in prior periods.
AASB 9 introduces a “cost of hedging” approach for options, forward contracts and cross currency basis swaps. Entities that have designated the intrinsic value of options as hedging instruments under AASB 139 must apply this approach to these options retrospectively. However, unlike options, entities that have designated forward contracts and instruments that have foreign currency basis such as cross currency swaps as hedging instruments have a choice whether or not to apply the cost of hedging approach retrospectively to these contracts.

Example 4 – Cost of hedging

This example applies the cost of hedging principle retrospectively for an option that was acquired out of the money for a premium of $10. The option remains out of the money over its term.

<table>
<thead>
<tr>
<th>Date of initial application</th>
<th>1 July 2017</th>
<th>1 July 2018</th>
<th>1 Aug 2018</th>
<th>30 June 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buy option</td>
<td>$9</td>
<td>$7</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Restating comparatives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Option</td>
<td>DR Cost of hedge reserve (CHS $3)</td>
<td>CR Opening Retained Earnings $0</td>
<td>DR CHS $1</td>
<td>CR P&amp;L $1</td>
</tr>
</tbody>
</table>

Under AASB 139, the change in fair value due to the time value component of the option would have been recorded in profit or loss. However, under AASB 9, these would be deferred in OCI.

If this entity elects to restate comparatives, it would:
- at 1 July 2017, transfer the amount relating to the change in fair value due to the time value of the option of $3 from opening retained earnings to a cost of hedging reserve; and
- reverse the movement in the time value component of the option of $1 from the income statement and recognise this movement against the cost of hedging reserve for the year ending 30 June 2018.

If the entity elects not to restate, it would at the DIA, that is, 1 July 2018:
- transfer the accumulated changes in the fair value due to the time value component of the option of $4 from the opening retained earnings to the cost of hedging reserve.

Note: if this option is hedging the purchase price of a piece of equipment, the balance of the cost of hedging reserve will be transferred into the carrying amount of the equipment. In this example, the option expires out of the money. Accordingly the cost of the option of $10 will be included in the carrying amount of the equipment.

1 Please speak to your KPMG adviser if you would like to know more about this principle.
Practical expedients are available to simplify the transition requirements

The transition provisions provide for a number of practical expedients relating to classification and measurement.

**Investments in hybrid contracts**

This expedient applies when the fair value of investments in hybrid contracts was not fairly valued in their entirety under AASB 139 in the comparative year and the entity chooses to restate prior periods on applying AASB 9. In this case, the fair value at the end of the comparative period shall be the sum of the fair values of the individual components (i.e. the non-derivative host and the embedded derivative).

**Financial assets with modified time value or prepayment features**

There are practical expedients on how to assess the nature of the cash flows of financial assets with a modified time value of money element or with a prepayment feature. Applying these practical expedients would tend to result in an outcome that they are not SPPI and therefore the assets would be FVTPL.

**Retrospective application of effective interest rate method**

If it is impracticable for entities to retrospectively apply the amortised cost method for an instrument previously measured at fair value:

- the fair value of the financial asset or liability at the end of each comparative period presented is the gross carrying amount of that financial asset or the amortised cost of that financial liability when the entity restates prior periods; or
- the fair value of the financial asset or liability at the DIA is the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the DIA when prior periods are not restated.

**Impairment**

Entities applying the general approach to impairment are required to determine the credit risk of the assets at the date of initial recognition to enable them to assess whether there has been a significant change in credit risk at the DIA. Entities identifying significant increases in credit risk on the basis of past due information can apply the rebuttable presumption that there has been a significant increase since initial recognition when the contractual cash flows are more than 30 days past due.

**Disclosures on transition and other considerations**

*AASB 7 Financial Instruments: Disclosures* has been amended for the issue of AASB 9 *Financial Instruments*. There are additional disclosures applicable only on transition to AASB 9 and on-going new disclosure requirements.
Disclosures on transition

The following are some examples (not an exhaustive list) of information that entities are required to disclose in the financial statements in the year of AASB 9 adoption. For example, for a 30 June entity, this would be the financial statements ending 30 June 2019.

Measurement category

Entities are required to disclose the original measurement category and carrying amount under AASB 139 (or an earlier version of AASB 9) and the new measurement category and carrying amount under AASB 9. Qualitative information such as the reasons for any designation into FVTPL or de-designation from FVTPL should also be disclosed.

An example of this disclosure can be found on page 220 of KPMG Example Public. An excerpt from the publication is shown below.

<table>
<thead>
<tr>
<th>In millions of aud</th>
<th>Original classification under AASB 139</th>
<th>New classification under AASB 9</th>
<th>Original carrying amount under AASB 139</th>
<th>New carrying amount under AASB 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>Note</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rate swaps used for hedging</td>
<td>24</td>
<td>Fair value – hedging instrument</td>
<td>Fair value – hedging instrument</td>
<td>131</td>
</tr>
<tr>
<td>Forward exchange contracts used for hedging</td>
<td>24</td>
<td>Fair value – hedging instrument</td>
<td>Fair value – hedging instrument</td>
<td>352</td>
</tr>
</tbody>
</table>

Re-measurement and Re-classification

AASB 7 requires the disclosure of the impact of re-measurement on transition to AASB 9. Examples of re-measurement include an increase in impairment provisions and a change in measurement basis (e.g. from Amortised Cost to FVTPL).

An example of this disclosure can be found on page 223 of KPMG Example Public. An excerpt from the publication is shown below.

The excerpt below provides an example of the impact of re-measurement on loans and receivables on transition.

<table>
<thead>
<tr>
<th>In millions of aud</th>
<th>AASB 139 carrying amount 31 Dec 2017</th>
<th>Reclassification</th>
<th>Remeasurement (increase in provision)</th>
<th>AASB 9 carrying amount 1 Jan 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>Amortised cost</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade and other receivables</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening balance: Loans and receivables</td>
<td>22,485</td>
<td></td>
<td>(160)</td>
<td>22,325</td>
</tr>
<tr>
<td>Remeasurement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing balance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Another transition disclosure is on any reclassifications upon adoption of AASB 9.

2 Examples of disclosures on transition can be found in KPMG Example Public.
The following table discloses the reclassification from the original category Available-for-sale, which no longer exists under AASB 9, to FVOCI.

<table>
<thead>
<tr>
<th>Financial assets</th>
<th>AASB 139 carrying amount</th>
<th>AASB 9 carrying amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available for sale (AFS)</td>
<td>31 Dec 2017</td>
<td>Reclassification</td>
</tr>
<tr>
<td>Opening balance:</td>
<td>884</td>
<td></td>
</tr>
<tr>
<td>To FVOCI - debt</td>
<td>(373)</td>
<td></td>
</tr>
<tr>
<td>To FVOCI - equity</td>
<td>(511)</td>
<td></td>
</tr>
<tr>
<td>Closing balance (AFS)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Reconciliation of provisions

Entities are required to disclose a reconciliation from the original allowance or provision levels under AASB 139 to the opening expected loss allowance under the new standard.

An example of this disclosure can be found on page 239 of KPMG Example Public. An excerpt from the publication is shown below.

<table>
<thead>
<tr>
<th>2018</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>In thousands of aud</td>
<td>Individual impairments</td>
</tr>
<tr>
<td>Opening balance</td>
<td>54</td>
</tr>
<tr>
<td>Adjustment on initial application of AASB 9</td>
<td>160</td>
</tr>
<tr>
<td>Balance at 1 January</td>
<td>214</td>
</tr>
<tr>
<td>Amounts written off</td>
<td>(94)</td>
</tr>
<tr>
<td>Net remeasurement of loss allowance</td>
<td>200</td>
</tr>
<tr>
<td>Balance at 31 December</td>
<td>320</td>
</tr>
</tbody>
</table>

Next steps

Depending on your organisation, transitioning to AASB 9 can be complex. The time to start your transition journey and impact assessment is now. Your KPMG contact is available to assist you through this process.

Contact us

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